

## **Monetary management and financial intermediation**

Prasanth C<sup>1</sup>, Anna K. Jacob<sup>2</sup>, K. Niranjana<sup>3</sup>

<sup>1</sup> Research Scholar, Department of Economics, Central University of Kerala, Kasaragod,

<sup>2</sup> 2nd PG Student, Department of Economics, Central University of Kerala, Kasaragod

<sup>3</sup> 2nd PG Student, Department of Economics, Central University of Kerala, Kasaragod

Monetary policy played a supportive role to the government along with the fiscal policy during the onset of the pandemic. Coordinated efforts by the Reserve Bank of India (RBI) in reducing the rates and the fiscal authority in providing fiscal stimulus are the outcome of the pandemic rather than any objective which is mainly enhancing economic growth. Since February 2020, the RBI has undertaken liquidity augmenting measures aimed at ensuring smooth functioning of financial markets and maintaining adequate flow of credit in the economy.

Among the major policy rates, the Monetary Policy Committee (MPC) has kept the Repo Rate and the reverse repo rate unchanged at 4.00 per cent and 3.35 per cent respectively since the previous revision in May, 2020. The status quo on these policy rates indicates an accommodative stance by the RBI by being more supportive to growth of the economy. Even though the inflation hovered in the upper bounds, the MPC was of the view that the elevated inflation levels were due to the supply shocks on the economy which would dissipate once the economy normalises. Considering the 'Omicron' variant of COVID-19, which was more like a flash flood rather than another wave, the policies hint at exiting the pandemic and moving towards normalisation. In this context, withdrawal of fiscal stimulus hinted by a contractionary fiscal policy is evident and the onus would be large on the monetary policy to reign the rising inflation expectations.

The monetary aggregates reveal a decline in the growth rates of Reserve Money (M0) and Broad Money (M3) over the previous fiscal. Within the components of M0, banker's deposits with RBI grew at 42 per cent in the year 2021-22. The currency in circulation (CIC) grew at 7.8 per cent as on 7th January, 2022, the lowest since demonetisation of 2016. The reasons for declined growth could be attributed primarily to reduced precautionary demand for cash. Expansion of M3 was largely due to the component of aggregate deposits. Money multiplier (MM) (given as M3/M0) which had been more or less steady during the period 1980-81 to 1995-96, witnessed an increasing trend up to 2016-17. The decline in MM continued till 31st March 2021 reaching 5.2, after which a slight improvement up to 5.3 was witnessed as on 31st December, 2021.

The central banks across the globe have withdrawn their accommodative stance on policy rates and even the RBI has been hinting the same with Variable Rate Reverse Repo (VRRR) which has been increased. The rebalancing of liquidity management by the RBI began in February 2020 with the shifting of RBI's liquidity absorption tool from fixed-rate overnight reverse repo window to VRRR. A key feature of the liquidity management of RBI in 2021-22 included gradual normalisation of liquidity management operations. RBI ensured adequate liquidity in the system along with accommodative monetary policy stance to support growth. RBI resorted to VRRR as the main operation under Liquidity Adjustment Facility (LAF). In May, 2021, the Cash Reserve Ratio (CRR) was raised to the pre-pandemic level of 4 per cent. Owing to surplus liquidity conditions the call money rate traded below the reverse repo rate which is the lower bound of the LAF during the year 2021-22. Further, the operating target of the RBI, the Weighted Average Call Rate (WACR) traded 13bps below the LAF corridor, before drifting back within the corridor in November 2021. In order to provide targeted liquidity support, RBI resorted to special refinance facilities to the tune of Rs. 66, 000 crores to All-India financial institutions, induced term-liquidity facility of Rs. 50, 000 crore to expand COVID-related health infrastructure, Special Long-Term Repo Operations (SLTRO) for small business units and MSMEs, on-tap liquidity window of Rs. 15, 000 crore for contract intensive sectors, and extension of 'On tap Targeted Long-Term Repo Operations' (On tap-TLTRO) till 31st December, 2021. Inducing further liquidity into the system, the secondary market G-sec Acquisition Programme (G-SAP) was announced during the year, under which RBI purchased G-secs amounting to Rs 2.2 lakh crore.

The banking sector of India has performed relatively well with improvement in the capital adequacy ratio (CAR) and reduction in the Gross/Net Non-performing Advances (GNPAs/NNPAs). GNPA and NNPA had peaked to 11.2 per cent and 6.0 per cent respectively in the year 2017-18, which fell to 6.9 per cent and 2.2 per cent respectively in September 2021. However, the Restructured Standard Advances (RSA) ratio of the Scheduled Commercial Banks (SCBs) witnessed an increase of 1.1 per cent from the figures of September 2020. COVID-19 related dispensations and moratoriums contributed to an increase in restructured assets, leading to an increase in the RSA. Improvement in the Capital to risk-weighted Asset Ratio (CRAR) of SCBs in both private and public sector was reflected in the overall CRAR at 16.54 per cent. It is noteworthy that all the Public Sector and Private Sector banks maintained the Capital Conservation Buffer (CCB) well over 2.5 per cent, which would ensure that banks have an additional layer of usable capital which could be used in case the banks incur losses.

Bank credit growth, which had been declining since 2019 from about 14 per cent, has witnessed a continued rise since the beginning of April 2021 from 5.3 per cent to 9.2 per cent as on 31st December 2021. Credit to agriculture registered a robust growth at 10.4 per cent in November 2021, while credit growth to industry turned positive reaching 3.8 per cent in November 2021, after it had turned negative in December 2020. Within the micro, small and medium enterprises (MSME) sector, the medium industries and the micro and small industries witnessed a surge in credit growth at 48.7 per cent and 12.7 per cent respectively in November, 2021, reflecting the effectiveness of RBI boost to the sector. In the Budget 2022-23, the extension of Emergency Credit Line Guarantee Scheme (ECLGS) up to March 2023 with an increase in its guarantee cover by Rs. 50,000 crore to total cover of Rs. 5 lakh will provide solace to MSMEs in the hospitality and related services which were drastically affected due to the pandemic.

The Economic Survey states 'Factoring' to be an important source of liquidity, especially for the MSMEs. Considering the recommendations of the Expert Committee on MSMEs under the Chairmanship of Shri. U.K. Sinha, the Factoring Regulation (Amendment) Act, 2021 was enacted. These amendments would liberalise the restrictive provisions of the Act and would widen the factoring ecosystem to provide larger avenues to the MSMEs for availing credit. However, the budget doesn't mention the aspect of factoring or the amendment to the Act.

On the digital payments front, United Payments Interface (UPI), the largest retail payment system in the country, accounted for transactions worth Rs, 8.26 lakh crore through 4.6 billion transactions in December, 2021. In October, RBI increased the daily limit of Immediate Payment Service (IMPS) from Rs. 2 lakh to Rs. 5 lakh with a view to boost digital payments.

On the Equity market front, the Economic Survey observes that during April-November 2021, initial public offerings (IPOs) of 75 companies have been listed, garnering Rs. 89,066 crore compared to 29 companies raising Rs14,733 crore during the same period in 2020, indicating a spectacular rise of 504.5% in fund mobilisation. Net Assets Under Management (AUM) of mutual fund industry rose by 24.4 per cent, while cumulative net investment by Foreign Portfolio Investors (FPIs) increased by 9.2 per cent as of November, 2021 when compared to the same period in the previous year.

The Budget announcement regarding the introduction of India's Central Bank Digital Currency (CBDC), which would give a boost to the digital economy is noteworthy. The RBI had already indicated as early as in July, 2021 that it would begin work on the 'phased implementation' of CBDC. Except as currency notes, all other use of paper in the modern financial system, be it as bonds, securities, transactions, communications, correspondences or messaging - has now been replaced by their corresponding digital and electronic versions. Use of physical cash in transactions too has been on the decline in recent years which has led many central banks and governments to step up efforts towards exploring a digital version of fiat currency. However, setting this up will require careful calibration and a nuanced approach in implementation. Though a crypto currency bill has not been tabled in the Parliament, the Budget 2022-23 has announced introduction of a 30 per cent tax on the transfer of virtual digital assets. Additionally, to ensure proper reporting of the transaction related to virtual digital assets, a TDS of 1 per cent on the virtual digital asset is introduced.

In conclusion, the monetary policy had resorted to extraordinary measures during the pandemic, but now, monetary policy is expected to anchor inflation and RBI would look forward to quantitative tightening, following the pursuit of major central banks across the globe.

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